

OFFICE OF THE ARMY GENERAL COUNSEL  
FISCAL LAW COURSE

OPERATING/CAPITAL LEASES

***SECTION H***

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OPERATING/CAPITAL LEASES

OPERATING/CAPITAL LEASES

- OWNERSHIP REMAINS WITH THE LESSOR AND IS NOT TRANSFERRED AT OR SHORTLY AFTER THE END OF THE LEASE TERM
- THERE IS NO BARGAIN PRICE PURCHASE OPTION
- ALL RISKS OF OWNERSHIP OF THE ASSET REMAIN WITH THE LESSOR, ABSENT GOVERNMENT NEGLIGENCE
- THE LEASE TERM DOES NOT EXCEED 75 PERCENT OF THE ESTIMATED ECONOMIC LIFE OF THE ASSET
- THE PRESENT VALUE OF THE MINIMUM LEASE PAYMENTS OVER THE LEASE LIFE DOES NOT EXCEED 90 PERCENT OF THE ASSET'S FAIR MARKET VALUE AT THE INCEPTION OF THE LEASE
- THE ASSET HAS A GENERAL, RATHER THAN A SPECIFIC GOVERNMENT PURPOSE, AND IS NOT BUILT TO UNIQUE GOVERNMENT SPECIFICATIONS
- THERE IS A PRIVATE SECTOR MARKET FOR THE ASSET
- THE ASSET IS NOT CONSTRUCTED ON GOVERNMENT LAND

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## OPERATING/CAPITAL LEASES

1. OWNERSHIP REMAINS WITH THE LESSER AND IS NOT TRANSFERRED AT OR SHORTLY AFTER THE END OF THE LEASE TERM

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## OPERATING/CAPITAL LEASES

2. THERE IS NO BARGAIN PRICE PURCHASE OPTION

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## OPERATING/CAPITAL LEASES

3. ALL RISKS OF OWNERSHIP OF THE ASSET REMAIN  
WITH THE LESSOR, ABSENT GOVERNMENT  
NEGLIGENCE

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## OPERATING/CAPITAL LEASES

4. THE LEASE TERM DOES NOT EXCEED  
75 PERCENT OF THE ESTIMATED ECONOMIC LIFE  
OF THE ASSET

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**EXAMPLE**

- o Street sweeper
- o Useful life (assumed) is 10 years
- o Lease term
  - oo One year
  - oo Option renewable each year, 4 additional years
- o "Lease term"
  - oo  $1 + 4 = 5$
  - oo  $5 < 10$
  - oo  $50\% < 75\%$  percent
- o Qualifies as an operating lease on this point

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## OPERATING/CAPITAL LEASES

5. THE PRESENT VALUE OF THE MINIMUM LEASE  
PAYMENTS OVER THE LEASE LIFE DOES NOT  
EXCEED 90 PERCENT OF THE ASSET'S FAIR  
MARKET VALUE AT THE INCEPTION OF THE LEASE



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**EXAMPLE**

- o Street sweeper
- o FMV - or cost if bought upfront - \$200,000
- o Annual lease payment - \$40,000
- o Five years (5 x 40,000 - \$200,000)
- o Present Value (PV)

$$\text{PMT 1} \quad \text{PMT 2} \quad \text{PMT 3} \quad \text{PMT 4} \quad \text{PMT 5} \\ (1 + r) + (1 + r)^2 + (1 + r)^3 + (1 + r)^4 + (1 + r)^5$$

- o  $r$  = Treasury rate for 5 year notes (equal to lease term) e.g., 8%
- o PV = \$159,708
- o 159,708 divided by 200,000 equals 79.8%
- o 79.8 percent is less than 90%
- o Qualified as operating lease on this point

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6. THE ASSET HAS A GENERAL, RATHER THAN A  
SPECIFIC GOVERNMENT PURPOSE, AND IS NOT  
BUILT TO UNIQUE GOVERNMENT SPECIFICATIONS

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## OPERATING/CAPITAL LEASES

7. THERE IS A PRIVATE SECTOR MARKET FOR THE ASSET

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## OPERATING/CAPITAL LEASES

8. THE ASSET IS NOT CONSTRUCTED ON  
GOVERNMENT LAND